



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201113036**
Release Date: 4/1/2011
Date: January 7, 2011

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.03-00

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Holly O. Paz
Acting Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224**

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

October 6, 2010

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

Applicant	=
State	=
Director A	=
Date 1	=
Foundation	=
Company	=
Director B	=
Date 2	=
Foreign Country	=
Applicant's Website	=
Company's Website	=

Dear

We have considered Applicant's form 1023 application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code of 1986, as amended (hereafter "Code"), as an organization described in section 501(c)(3) of the Code. Based on the information submitted, we have concluded that Applicant does not qualify for exemption under that section. The basis for our conclusion is set forth below.

I. FACTS

1. Organizational Purpose

Applicant is a nonprofit corporation organized under the laws of State. Applicant was formed by Director A on Date 1 under the name of Foundation. Subsequently, on Date 2, Applicant amended its Articles of Incorporation to change its name from Foundation to Applicant. Section Three of its Articles of Incorporation provides that it is organized to engage in section 501(c)(3) activities, including, but not limited to, the following:

- A. Encouraging and facilitating contributions to organizations for charitable purposes through the creative use of modern communications tools and technology, including by establishing and maintaining a website to process charitable contributions over the Internet;
- B. Making grants to organizations that carry on charitable activities to promote social and economic change in [Foreign Country] and other countries, including but not limited to grants to benefit education, community development, poverty alleviation, disaster relief, public health and the protection of natural resources;
- C. Providing a global, online network for non-profit organizations to connect with supporters, volunteers and partners.

The narrative description contained in Applicant's application provides that it was created to establish and maintain a website, receive and process charitable contributions over the Internet, provide support and assistance to encourage contributions to charities and to make grants exclusively for religious, charitable, scientific, literary or educational purposes.

Applicant's narrative description also stated that most of the contributions it receives will be part of its general fund. Donors to the general fund may recommend organizations in the U.S. or abroad that have been pre-approved as grantees. For a large contribution, a donor may establish a donor advised fund. Applicant stated that it does not anticipate maintaining many donor advised funds, but that its board of directors will retain ultimate discretion and control over its entire grant making activities and will make investment decisions without input from donors. Currently, Applicant does not maintain any donor advised funds.

Applicant presently has five directors on its governing board. In its narrative description, Applicant described the connection between its directors and Company, a for-profit foreign entity. Director A is Applicant's Director, President and Treasurer, and a controlling shareholder in Company. Company's other controlling shareholder is Director B, who is also Applicant's Director, Vice-President and Secretary. Both Director A and Director B serve on the Board of Directors of Company.

2. Foreign Grant Making

In a letter dated November 4, 2009, Applicant stated that it operates solely as a grant making organization. Specifically, Applicant stated that its grant-making program focuses on foreign grantees, and in particular, organizations operating in Foreign Country.

In a letter dated November 4, 2009, Applicant stated that its foreign grant-making program will utilize the internet to permit donors to make donations to organizations operating in Foreign Country. Specifically, prospective donors will access Applicant's Website and be directed to Company's Website for a list of organizations approved for donations. Applicant stated that "the link to [Company's Website] that is provided on [Applicant's Website] serves to direct the [Applicant's] potential donors to [Company's Website] so that they can browse approved charitable projects. Once a donor selects a project and makes a contribution to [Applicant] with his or her recommended project, the [Applicant] makes a grant directly to the grantee organization." Applicant also reported that individuals that access Company's Website directly,

to make donations to organizations listed on Company's Website, will be redirected to Applicant's Website to permit them to make donations to these organizations through Applicant. Specifically, Applicant stated that "[t]he link to [Applicant's Website] that is provided on [Company's Website] serves to direct U.S. donors who wish to support the charitable projects on [Company's Website] to [Applicant's Website] so that they can make their contributions directly to the [Applicant]."

3. Applicant Contracts with Service Provider to Operate Applicant's Grant-Making Program

Applicant represented that it will further its charitable purposes by making charitable project grants to foreign organizations that are pre-screened by Company. Specifically, Applicant represented that it contracted with Company to screen potential grantees on its behalf because it is unable to perform the required due diligence necessary to engage in foreign grant-making activities on its own. Applicant stated the following:

With respect to organizations formed outside the U.S., the [Applicant] currently does not have the capacity to perform the required due diligence and therefore will hire a service provider to evaluate foreign organizations according to criteria that is provided by the [Applicant] and approved by the [Applicant]'s Board of Directors. The [Applicant]'s Board will then take the results of the evaluations performed by the service provider and decide whether the foreign grantee is a suitable grantee of the [Applicant].

The service provider Applicant has chosen to perform its due diligence is Company. Specifically in reference to Company, Applicant stated the following:

The service provider the [Applicant] has identified at this time is [Company], a [Foreign Country] mission-driven corporation that was formed by two of the directors of [Applicant] (but which is not controlled by and which does not control the Organization)... [Company] is the owner and operator of a website called [Company's Website] that is devoted to disseminating information about charitable organizations located all over the world and their projects. The [Applicant] has entered into a Linking and Services Agreement with [Company] (substantially in the form attached as Exhibit E) pursuant to which [Company] will evaluate organizations according to criteria that is provided by the [Applicant] and allow those organizations that meet the criteria to post descriptions of themselves and their projects on the [Company's Website].

Applicant submitted a copy of its *Linking and Services Agreement* with Company. Specifically, Applicant's contract with Company requires Company to (i) review if a proposed foreign grantee is classified as a non-profit/charity in their home country; (ii) determine the period of proposed grantee's operation; (iii) review the proposed grantee's organizational and operational documents for compliance with section 501(c)(3) of the Code; (iv) review the proposed grantee's financial documents; (v) investigate the proposed grantee's governing boards; (vi) review the proposed grantee's project and budget to conform to section 501(c)(3) requirements; (vii) verify the proposed grantee is not listed with the U.S. Office of Foreign Asset Control; and (viii) prepare a recommendation report for Applicant.

4. How Company was Selected by Applicant

Applicant was asked to provide information as to how it selected Company. Applicant reported that it hired Company without interviewing other service providers. When asked why Applicant hired Company without interviewing other service providers, Applicant responded that it "did not interview other firms because it was not able to identify any other firms that have the expertise [Company] has with respect to foreign (and especially [Foreign Country]) organizations and that provided substantially similar due diligence services to U.S. grant making organizations." As to the issue of fees, Applicant reported that for the first year Company is donating its services to Applicant. For the second year, Applicant reported that Company will charge service fees that will be negotiated at "arms-length." Furthermore, Applicant acknowledged its close ties with Company, and stated that "[t]he [Applicant] has a 'close connection' with [Company] because it was created at approximately the same time and by some of the same persons as [Company]."

5. Company's Activities on Behalf of Company's Own Clients

Applicant reported that Company is a for-profit company established by Director A and Director B in Foreign Country. Company earns income by charging described non-profit organizations located in Foreign Country a fee for listing these organizations' projects on Company's Website.

6. Applicant's Review of Company's Due Diligence Functions

Applicant was asked to describe the due diligence performed by Company on Applicant's behalf, and the review and oversight Applicant performs to verify that prospective grantees recommended by Company merit grants. Specifically, Applicant was asked to provide copies of its grant applications. Applicant responded that it hired Company to conduct due diligence on its behalf and that Company uses its own grant application. Applicant submitted several of Company's grant applications as representative samples of the information Company collects as part of its due diligence function. Review of these documents show that Company's grant application is composed of a two-page registration form and a three-page project form. These forms request the name and contact information of both the organization and its directors, a short description of the organization's project, its goals, needs, and uniqueness, and information as to both the project's target population and its budget.

Applicant was also asked to describe the selection process it uses to select which foreign organizations will receive grants. Applicant responded that Company selects the potential grantees then performs its due diligence functions to make a final determination as to which organizations merit a grant. After company selects potential grantees, Company forwards to Applicant all documents it used in selecting these grantees so Applicant may review the documentation to verify that prospective grantees recommend by Company do indeed merit a grant. Specifically, Applicant stated that "[i]f as a result

of its due diligence, [Company] determines that the proposed grantee and its charitable project fall within the criteria set by [Applicant] and thus are eligible to receive grants from [Applicant], [Company] will forward the materials received from the proposed grantee to [Applicant]."

Applicant was specifically asked to supply copies of reports provided by Company in support of Company's selection of grantees. Applicant responded that "[it] reviews the list of organizations and supporting material provided by [Company] to ensure that each proposed grantee meets the criteria set by [Applicant]". However, Applicant only submitted copies of applications from potential grantees. No other supporting material was provided. Applicant stated that as part of its process to review Company's selection of potential grantees, Company's representative presents a verbal report to Applicant's selection committee in support of Company's decision, during which time Applicant's selection committee has the opportunity to ask the representative questions.

Applicant was asked to provide copies of the minutes of the selection committee meetings to show the process used by Applicant to review Company's selection of grantees. Applicant submitted a one page document, dated July 15, 2009, evidencing the selection committee meeting. The July 15th minutes provided the following information:

[Company] presented the up to date report of activity. [Company] asked for any questions on the list [Company] had developed. There was a discussion of the projects [Applicant] was funding, more specifically about the stress prevention center and the program. It was interesting to the Board that these programs all fell under the heading of mental health. Following the presentation, the Board was asked to approve recommendations for allocation of funds to the list of organizations which had been vetted by [Company]. The Board approved unanimously.

7. Grants Awarded

Applicant reported that it has awarded foreign grants to 55 organizations. Applicant was asked to provide information as to how many of its grantees, foreign or non-foreign, were not vetted by Company. Applicant responded that all grant recipients to date have been vetted by Company.

II. **LAW**

Section 501(c)(3) of the Code exempts from taxation any corporation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, provided no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Treasury Regulations (hereafter “regulations”) defines private shareholder or individual as a person having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in section 501(c)(3). If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet the requirement of this subsection, the burden of proof is on the organization to show that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term “charitable” is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes, among other things, relief of the poor and distressed or of the underprivileged, advancement of religion, advancement of education or science.

Rev. Rul. 56-304, 1956-2 C.B. 306 holds that an organization that makes distributions of its funds to individuals “should maintain adequate records and case histories to show the name and address of each recipient of aid; the amount distributed to each; the purpose for which the aid was given; the manner in which the recipient was selected and the relationship, if any, between the recipient and (1) members, officers, or trustees of the organization, (2) a grantor or substantial contributor to the organization or a member of the family of either, and (3) a corporation controlled by a grantor or substantial contributor, in order that any or all distributions made to individuals can be substantiated upon request by the Internal Revenue Service.”

Rev. Rul. 63-252, 1963-2 C.B. 101, holds that organizations created in the United States but operated solely to solicit earmarked funds on behalf of pre-existing foreign entities are in effect domestic agents or conduit organizations with respect to foreign beneficiaries and do not qualify for tax-deductibility of donations. In this ruling, the Service also holds that qualifying tax-exempt domestic organizations are independent actors with their own charitable programs who exercise discretion and control over funds solicited within the United States. The Service provided examples of qualifying organizations, including “[a]n exempt domestic charity that

makes grants to foreign charities after reviewing the grant applications to ensure that the foreign activities will further its own charitable purposes."

Rev. Rul. 66-79, 1966-1 C.B. 48, holds that an organization created in the United States that solicits contributions in the United States for a specific project of a foreign counterpart organization will qualify for tax-deductible contributions where the domestic charity has reviewed and approved the project as being in furtherance of its own exempt purposes and has control and discretion as to the use of the contributions. In this ruling, the Service holds that the domestic organization had demonstrated that it has full control of the donated funds and discretion as to their use so as to insure that the funds will be used to carry out the domestic charity's function and purposes. The board of directors of the domestic organization has taken specific steps to carefully review the project in advance of any funding and to monitor its continued adherence to the domestic charity's goals.

Rev. Rul. 68-489, 1968-2 C.B. 210 holds that an organization will not jeopardize its exemption under section 501(c)(3) of the Code, even though it distributes funds to nonexempt organizations, provided it retains control and discretion over use of the funds for section 501(c)(3) purposes. In this ruling, an organization exempt from Federal income tax under section 501(c)(3) distributed part of its funds to organizations not themselves exempt under section 501(c)(3). The exempt organization ensures use of the funds for section 501(c)(3) purposes by limiting distributions to specific projects that are in furtherance of its own exempt purposes. It retains control and discretion as to the use of the funds and maintains records establishing that the funds were used for section 501(c)(3) purposes.

Rev. Rul. 70-186, 1970-1 C.B. 128, discusses an organization formed to preserve and enhance a lake as a public recreational facility by treating the water. The lake is large, bordering on several municipalities. The public uses it extensively for recreation. Along its shores are public beaches, launching ramps, and other public facilities. The organization is financed by contributions from lake front property owners, members of the adjacent community, and municipalities bordering the lake. The revenue ruling concludes that the benefits from the organization's activities flow principally to the general public through well maintained and improved public recreational facilities. Any private benefits derived by the lake front property owners do not lessen the public benefits flowing from the organization's operations. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

Rev. Rul. 75-65, 1975-1 C.B. 79, discusses a domestic charity formed to deal with the problem of plant and wildlife ecology in a foreign country through programs that include grants to foreign private organizations. The domestic charity maintains control and responsibility over the use of any funds granted to a foreign organization by first making an investigation of the purpose to which the funds will be put, by then entering into a written agreement with the recipient organization, and lastly by making field investigations to see that the money is spent in accordance with the agreement. The charity exercises the power to require fund accountability over these programs and contributions to the organization are deductible.

Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of private benefit, if substantial in nature, will destroy

an organization's tax-exempt status regardless of the organization's other charitable purposes or activities.

est. of Hawaii v. Commissioner, 71 T.C. 1067 (1979), the Tax Court held that compensation need not be unreasonable or exceed fair market value to be private benefit, stating "[n]or can we agree with petitioner that the critical inquiry is whether the payments made to International were reasonable or excessive. Regardless of whether the payments made by petitioner to International were excessive, International and EST, Inc., benefited substantially from the operation of petitioner."

P.L.L. Scholarship v. Commissioner, 82 T.C. No. 17, 82 T.C. 196 (1984), the Tax Court found that an organization that operated charitable bingo on the premises of a bar allowed the bar to increase its sales of food and drinks by its operations in the bar; thereby, benefiting the bar in more than an insubstantial way. The organization and bar were controlled by some of the same persons. The Court held that the operations of the organization and bar were so interrelated as to be "functionally inseparable," the effect of which was that any economic benefit the bar received was not incidental.

Church by Mail v. Commissioner, 765 F. 2d 1387 (9th Cir. 1985), aff'g TCM 1984-349 (1984), the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated: "The critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."

American Campaign Academy v. Commissioner, 92 TC 1053 (1989), the Tax Court defined private benefit as "nonincidental benefits conferred on disinterested persons that serve private interests."

International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36 (1989), an organization, whose activity was to conduct continuing medical education tours abroad, exclusively used one for-profit travel agency to arrange its travel tours. The same individuals controlled both the organization and the for-profit travel agency, and the organization did not solicit bids from any other travel agency. Furthermore, both entities shared the same office. As both entities were interrelated, the Court held that the organization was operated for the benefit of the for-profit travel agency.

III. RATIONALE

For Applicant to qualify as a tax-exempt organization under section 501(c)(3) of the Code, Applicant must be organized and operated exclusively for charitable or other exempt purposes, with no part of Applicant's net earnings inuring to the benefit of any private shareholder or individual. Applicant reported that it is seeking tax-exempt status solely for operating a grant-making program, which to date has only made grants to foreign, non-501(c)(3) organizations. Review of Applicant's activities show that Applicant does not exercise the required discretion and control over its foreign grants, which grants do not further its exempt purpose and that

Applicant's business relationship with Company results in an impermissible private benefit to Company. Therefore, Applicant fails to meet the requirements necessary to be recognized as a tax-exempt organization under section 501(c)(3).

1. Non-Exempt Purpose:

The first issue is whether Applicant is operated exclusively for tax-exempt purposes as defined under section 501(c)(3) of the Code and section 1.501(c)(3)-1 of the regulations, for its sole activity of operating a program to award grants to foreign, non-501(c)(3) organizations.

Applicant has failed to establish that it is operated for exempt purposes under section 501(c)(3) of the Code. Applicant does not carry on a substantial charitable program as required under section 501(c)(3) and section 1.501(c)(3)-1(d)(2) of the regulations. Instead, Applicant operates a website to raise funds that are then donated to foreign organizations. It is well established that an organization will not be considered as operated for an exempt purpose if it acts as a conduit organization by operating to collect U.S. donations earmarked for foreign non-501(c)(3) organizations. See, Rev. Rul. 63-252. To qualify for exempt status, a grant-making organization must establish to the satisfaction of the Service that its grants to foreign organizations furthers its exempt purposes and that it exercises appropriate discretion and control as to the use of its grants for section 501(c)(3) purposes. See Rev. Rul. 68-489. Applicant has failed to demonstrate that it exercises sufficient discretion and control over its grant making program, and it has failed to demonstrate that its grant-making program furthers its tax-exempt purpose. Therefore, Applicant is not operated for tax-exempt purposes under section 501(c)(3).

Review of Applicant's documents and representations fails to demonstrate that Applicant is exercising the appropriate level of discretion and control over its grant-making program to qualify for exemption under section 501(c)(3) of the Code. Applicant does not conduct its own grant-making program. Rather, Applicant hired Company to perform substantially all operations related to its grant-making program. Applicant admitted that it has not developed any grant applications. It does not select which potential grantees receive grant applications. It does not review any grant applications. It does not review any documents submitted with grant applications. It does not conduct any investigations of potential grantees. It does not select grant recipients. It does not conduct follow-up reviews or investigations of grantees' use of grants. Applicant's activities are in contrast to the activities of exempt organizations recognized for exercising appropriate levels of discretion and control over their foreign grant-making programs. Applicant is not like the exempt organization described in Rev. Rul. 63-252, which maintained discretion and control over its grants by reviewing grant applications to ensure continued adherence to the organization's charitable goals. Applicant is also not like the exempt organization described in Rev. Rul. 66-79, which maintained discretion and control by conducting both pre-grant and post-grant reviews. Furthermore, Applicant is not like the exempt organization described in Rev. Rul. 75-65, which maintained discretion and control by first making an investigation of the purpose to which the funds would be used, then entering into a written agreement with the recipient organization, and lastly, by making field investigations to see that the money was spent in accordance with the agreement. Finally, Applicant is not like the exempt organization described in Rev. Rul. 56-304, which maintained discretion and control by maintaining adequate records and case histories to show the name and address of each

recipient of aid; the amount distributed to each; the purpose for which the aid was given; the manner in which the recipient was selected and the relationship, if any, between the recipient and the grantor or related parties in order that any or all distributions made to individuals could be substantiated upon request by the Internal Revenue Service.

Applicant represented that it performs a substantial review of Company's activities to support a finding that it exercises appropriate levels of discretion and control over the awarding of its grants. However, the information submitted fails to show a detailed review by Applicant of all grant forms and supporting legal and financial documentation submitted by potential grantees. Rather, in response to our inquiry, Applicant submitted copies of Company's two-page registration form and a three-page grant form, which forms only contain basic information about the potential grantee. The record does not contain any legal or financial documents submitted by potential grantees, no discussion of the inquiry directed to potential grantees as to grantees potential use of funds, no evidence of any investigations into potential grantees to determine conflicts of interest or jeopardizing activities on the part of potential grantees, and no discussion of post grant follow-up. Instead, Applicant represented that all inquiry and review is conducted when Company's representative submits a verbal report to Applicant's board of directors. However, review of Applicant's minutes related to its board of directors meeting does not show any meaningful discussion. There is no evidence of any discussion relating to applications filed by potential grantees; no discussion of how grantees are going to use the funds; and no evidence that Company conducted investigations of potential grantees. Therefore, Applicant has not demonstrated that it exercises appropriate levels of discretion and control over its grant making program. Absent appropriate levels of discretion and control, Applicant's grant-making program operates as a conduit to direct charitable donations to non-501(c)(3) organizations, which activity has not been recognized as charitable. See, Rev. Rul. 63-252. Therefore, Applicant is not operated for tax-exempt purposes under section 501(c)(3).

2. Impermissible Private Benefit

The second issue is whether Applicant's earnings inure to the private benefit of any individual or entity as defined under section 501(c)(3) of the Code and section 1.501(c)(3)-1 of the regulations.

Under section 501(c)(3) of the Code, an organization must be operated exclusively for exempt purposes, and will not be so operated if more than an insubstantial part of its activities are not in furtherance of an exempt purpose. See also section 1.501(c)(3)-1(c)(1) of the regulations. As the Supreme Court held, the presence of private benefit, if substantial in nature, will destroy the exemption of an organization, regardless of an organization's other charitable purposes or activities. Better Business Bureau, 326 U.S. 279 (1945). Private benefit has been defined as "nonincidental benefits conferred on disinterested persons that serve private interests. American Campaign Academy v. Commissioner, 92 TC 1053 (1989). The information provided by Applicant shows that its operations are so functionally interrelated with Company, so as to result in an impermissible private benefit to Company, Company's shareholders (Director A and Director B), and Company's clients listed on Company's Website.

It is well established that an impermissible private benefit results when for-profit organizations are functionally interrelated with exempt organizations. See, P.L.L. Scholarship v.

Commissioner, and International Postgraduate Medical Foundation v. Commissioner, *supra*. Here, Company is functionally interrelated with Applicant. The record shows that both Applicant and Company were established by the same persons –Director A and Director B. Both Director A and Director B serve on the boards of both Applicant and Company and are shareholders of Company. Company was hired by Applicant to conduct its foreign grant-making activity without competitive bidding. Applicant admitted that it had not solicited any bids for similar services or had even considered any entity other than Company. Company is a for-profit entity that is also a fundraiser for foreign entities operating in Foreign Country. Through Company's Linking Services Agreement with Applicant, both Applicant and Company share Internet links through their websites. The Linking and Services Agreement provides that Applicant's Website links to Company's Website for prospective U.S. donors to view the list of organizations and their projects. Prospective U.S. donors can then make donations to the organizations listed on Company's Website in support of particular projects. These donations pass through Applicant, with Applicant being the entity that forwards these donations to the selected organizations. The effect of this functional interrelationship is to allow Company's clients to receive grants funneled through Applicant that originate as tax-deductible donations from U.S. citizens. Company's business reputation is enhanced as a successful fundraiser by advertising dozens of successful grantees on its website. This in turn spurs new business as clients are more willing to hire a successful fundraiser. Company increases its revenues, Company's clients increase their donations, and Director A and Director B increase the value of their business, all resulting in an impermissible private benefit.

Company is given a substantial and intentional private benefit as a result of its contract with Applicant. Although Applicant stated that Company's fees will be fixed in "arms-length" negotiations, because Applicant hired Company without competitive bidding, Company is given a substantial private benefit similar to the for-profit travel agency in International Postgraduate Medical Foundation, T.C. Memo 1989-36 (1989). As the Courts held in est. of Hawaii v. Commissioner, 71 T.C. 1067 (1979), and Church by Mail v. Commissioner, 765 F. 2d 1387, a finding of private benefit does not require that payment for services be unreasonable or exceed fair market value. Because Company is so functionally interrelated with Applicant, even if Company is compensated based upon a contract negotiated at "arms-length," Company, and Company's clients and shareholders, receive an impermissible private benefit.

Private benefit is permissible when it is an unintentional and unavoidable byproduct of charitable activity, such as cleaning up a public lake with the unintentional and unavoidable benefit of a clean lake to private individuals who own adjacent lake-front property. See, Rev. Rul. 75-286. Here, the benefit to Company, its shareholders and its clients is intentional and a direct result of Company's business being so functionally interrelated with Applicant's activities. Therefore, Applicant is not operated for a tax-exempt purpose under section 501(c)(3) of the Code.

Based upon the above, we have made a determination that Applicant fails to meet the requirements necessary to be recognized as a tax-exempt organization under section 501(c)(3) of the Code. Applicant has the right to file a protest if it believes this determination is incorrect. To protest, Applicant must submit a statement of its views and fully explain its reasoning. Applicant must submit the statement, signed by one of its officers, within 30 days from the date of this letter. We will consider Applicant's statement and decide if the information affects our determination.

Applicant's protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

Applicant also has a right to request a conference to discuss its protest. This request should be made when Applicant files its protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent Applicant. If Applicant wants representation during the conference procedures, it must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if it has not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If Applicant does not intend to protest this determination, it need not take any further action. If we do not hear from Applicant within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to this address:

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:3)
xxxxxxxxxxxxxxxxxxxxxxxxxxxx
1111 Constitution Ave, N.W.
Washington, DC 20224

Applicant may also fax its statement using the fax number shown in the heading of this letter. If Applicant faxes its statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, you may contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Holly O. Paz
Acting Director, Exempt Organizations
Rulings & Agreements